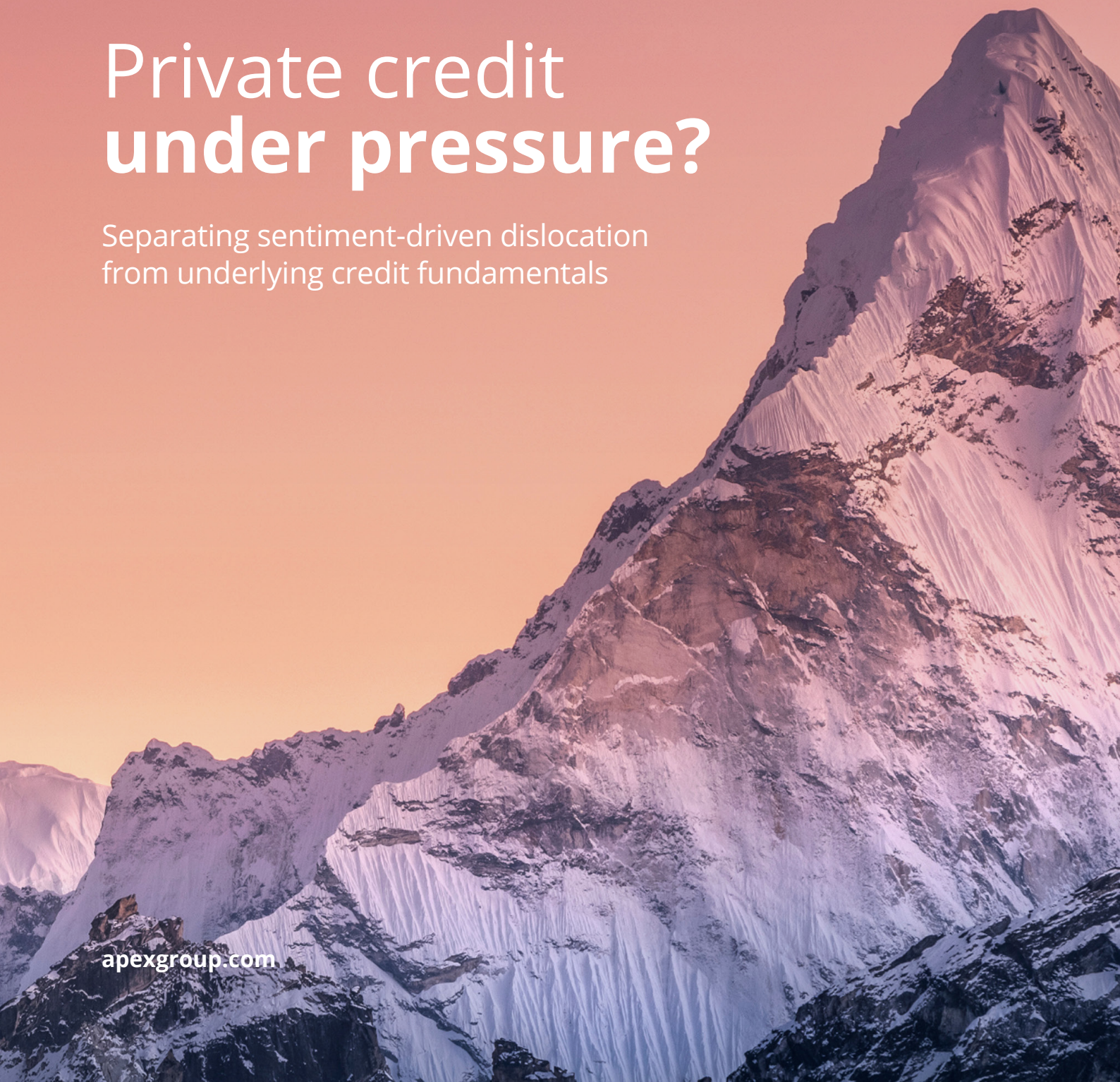
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Private credit **under pressure?**

Separating sentiment-driven dislocation from underlying credit fundamentals



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Executive summary

Private credit has evolved from a niche post-Global Financial Crisis ("GFC") opportunity into a c.$2 trillion asset class, supported by structural dislocation in bank lending and sustained demand from institutional investors seeking income, diversification, and downside protection.

The volatility observed in 2026 represents the first meaningful large-scale stress test of the asset class. While redemption pressures and valuation concerns drove dislocation, the evidence suggests this was primarily driven by liquidity mismatches and investor sentiment rather than systemic deterioration in underlying credit quality.

For institutional investors, private credit remains a compelling allocation. However, the environment has shifted, and success will depend increasingly on sound strategy and manager selection, underwriting discipline, and a more granular understanding of portfolio vulnerabilities and credit risks.

1. The structural rise of private credit

Private credit has evolved from a niche post-Global Financial Crisis ("GFC") opportunity into a c.$2 trillion asset class, supported by structural dislocation in bank lending and sustained demand from institutional investors seeking income, diversification, and downside protection.

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2. Why private credit has been so compelling

Private credit has offered a compelling combination of income, downside protection, and diversification:

Stable income:
Floating-rate, contractual cashflows with low interest-rate sensitivity

Illiquidity premium:
Consistent yield pick-up versus public markets

Diversification:
Lower correlation with public markets

Downside protection:
Senior secured positioning and lender control

Flexibility:
Ability to construct tailored portfolios

Prior to 2026, these characteristics translated into consistent, income-driven returns for investors, typically in the range of c.8–10% over the long term, with recent vintages benefiting from higher base rates and spreads, driving double-digit returns (c.10–14%) across many private credit strategies. Default rates remained low (generally below 2%), with consistent outperformance versus public high yield strategies over the long-term. These factors reinforced private credit as a core institutional allocation.

3. 2026: A sentiment shock

2026 saw a sharp shift in sentiment, with over $30bn in redemption requests, primarily from semi-liquid fund structures.

Importantly, this did not translate into equivalent outflows.

Most semi-liquid private credit vehicles are structurally designed with redemption limits – commonly around 5% of NAV per quarter. These are not ad-hoc "gates" imposed in stress, but pre-defined features designed to:

- Protect portfolio integrity
- Avoid forced selling of illiquid assets
- Maintain underwriting discipline

A key distinction is that while redemption requests increased materially, actual redemptions remained capped. These increased redemption requests often reflect investor activity and sentiment, rather than an immediate deterioration in underlying credit fundamentals, which remain broadly intact in many instances.

While media coverage framed this as a liquidity crisis, in practice, these mechanisms often functioned as intended, protecting long-term investors and preserving portfolios, albeit redeeming investors were not always fully aware beforehand. This episode, however, exposed key vulnerabilities, particularly the tension between illiquid underlying assets and periodic liquidity offered to investors.

4. Drivers of recent volatility

Several factors contributed to the recent dislocation:

Default fears increased, particularly in software, where concerns over AI disruption triggered sharp market declines and raised questions about borrower resilience

Weakening underwriting: Underwriting standards weakened in certain vintages, notably 2021–2022, with higher leverage, covenant-lite structures, and increased use of payment-in-kind ("PIK") features

Valuation uncertainty emerged, as private assets are marked infrequently and rely on models rather than observable transaction data

Liquidity mismatches became evident in semi-liquid vehicles, where redemption demand could not be immediately met due to the illiquid nature of underlying loans

These forces combined to create a sentiment-driven repricing amid increased uncertainty and increasing credit risk, rather than a structural breakdown of the asset class.

A key takeaway from 2026 is the need to distinguish between liquidity-driven dislocation and fundamental credit deterioration.

Importantly, private credit fund structures often behaved largely as designed. Redemption limits helped avoid forced asset sales and protected long-term investors, reinforcing the structural integrity of the asset class.

Volatility was concentrated in listed and semi-liquid vehicles, while traditional closed-end funds remained largely insulated, highlighting the importance of appropriate terms and vehicle design in accordance with the fundamental features of the asset class, along with rigorous due diligence in strategy and vehicle selection.

5. Credit quality fundamentals: normalisation, not crisis

In aggregate, credit quality has generally weakened relative to an unusually benign period but remains fundamentally sound at an asset class level, with some areas of greater vulnerability that investors should be mindful of.

Default rates: Increased from less than 2% historically to about 5–6% in 2026 (including selective defaults and liability management exercises)

Early stress indicators: Rising PIK usage, covenant amendments, and maturity extensions, signaling increasing borrower pressure and active liability management before defaults occur

However, this deterioration must be viewed in context:

- Prior default levels were artificially suppressed by excess liquidity
- Current conditions reflect more typical credit conditions rather than systemic stress, following an extended period of unusually low defaults

Importantly, loss outcomes remain contained:

- Recovery rates: typically, 70–100% for senior lenders
- Many "defaults" are restructurings or liability management exercises, rather than permanent impairments, with actual losses typically representing a fraction of reported default rates due to strong recovery levels

Overall, the key risk in private credit today is not asset class deterioration, but dispersion driven by underwriting discipline.

Outcomes are increasingly determined by:

- Investment manager quality and skill
- Sector exposure
- Strategy type
- Vintage (particularly 2021–2022, reflecting a period of higher leverage and looser underwriting)
- Underwriting discipline

It also is important to distinguish between different private credit strategies (e.g., seniority in capital structure, sponsored vs. non-sponsored debt, asset-backed features, ability to deal with deteriorating credits), which may result in different risk factors.

6. Sector focus: Differentiating software exposure

Software exposure has been central to recent concerns, but risk is **highly differentiated.**

More resilient: Mission-critical, embedded businesses with high switching costs and recurring revenues

More vulnerable: Commoditised, discretionary, or highly competitive SaaS models

As a result, software exposure alone is not a sufficient indicator of risk, with credit outcomes increasingly driven by:

- Business model quality – resilience of cashflows, pricing power, and customer stickiness
- Sponsor strength – financial support, track record, and willingness to inject capital
- Underwriting discipline – leverage, structure, and covenant protection



7. Implications for institutional investors

As highlighted above, the volatility observed in 2026 was largely driven by elevated redemption requests and liquidity pressures, which have brought greater scrutiny to private credit. While this episode exposed structural vulnerabilities in certain fund vehicles, underlying borrower performance has remained broadly resilient, with stress concentrated rather than systemic.

That said, the environment is clearly shifting:

- Defaults are rising from low levels
- PIK usage is increasing
- Software risk remains highly differentiated
- Public market signals (e.g., Business Development Company discounts) point to greater skepticism around valuations

Against this backdrop, the current environment requires a more selective and analytical approach to private credit investing.

We believe the following are key areas investors need to focus on when making an investment in private credit:

- **Underwriting quality:** Carefully examine leverage, capital structure, covenant protection
- **Early warning signals:** Monitor PIK usage, covenant amendments, and maturity extensions, which can indicate underlying borrower stress before defaults occur
- **Valuation realism:** Cross-check private market valuations against relevant public market metrics, focusing on underlying cash flow health and credit metrics rather than relying solely on reported NAVs
- **Portfolio construction:** Look through sector labels and ensure appropriate vintage diversification (particularly exposure to 2021–2022 vintages)
- **Structural complexity (particularly for insurers):** In parts of the market, offshore structures (e.g., reinsurance) can enhance capital efficiency, but may also obscure how risks are ultimately held and transmitted, making transparency and robust, lookthrough investment and operational due diligence increasingly important

8. Opportunity in dislocation: Secondaries

The 2026 dislocation has created opportunities in the secondary market, driven by liquidity dynamics rather than underlying credit deterioration, due to:

- Increased supply from liquidity-driven sellers
- Greater pricing dispersion across portfolios and managers
- Access to high-quality assets at discounted valuations

Importantly, these discounts are largely technical in nature – reflecting liquidity pressures rather than a broad-based deterioration in credit quality.

For long-term investors, this creates an attractive entry point, offering:

- Accelerated deployment
- Enhanced return potential
- Improved vintage diversification

For further detail, please refer to our previous Insight: **Secondaries – Should private credit secondaries have a role within your portfolio?** which explores the investment case for LP-led secondaries and their role within a diversified portfolio.

9. Conclusion

Private credit is entering a more mature phase, typified by greater scrutiny, increased dispersion, and a shift from unusually benign conditions to a more normal credit environment.

The events of 2026 highlighted structural vulnerabilities in liquidity design, rather than underlying credit per se, and reinforced the importance of robust manager selection and due diligence and underwriting discipline.

Importantly, however, this does not undermine the core investment case for private credit in many cases. This reflects a return to normal of conditions following an extended period of exceptionally favourable markets, rather than a structural deterioration in the asset class.

When it is accessed through appropriate strategies and fund structures, private credit as an asset class should remain a compelling allocation for institutional investors. However, outcomes will increasingly be driven by selectivity, discipline, and manager expertise, rather than broad market tailwinds that have propelled the rapid growth of the market in recent years.

How we support institutional investors

We work with institutional investors to design and implement resilient private credit allocations, supporting both strategic allocation decisions and manager selection, and due diligence across market cycles.

We can support clients in repositioning private credit mandates, including refining strategy mix, reviewing investment manager's underwriting processes, and navigating periods of market dislocation.

Our approach is grounded in:

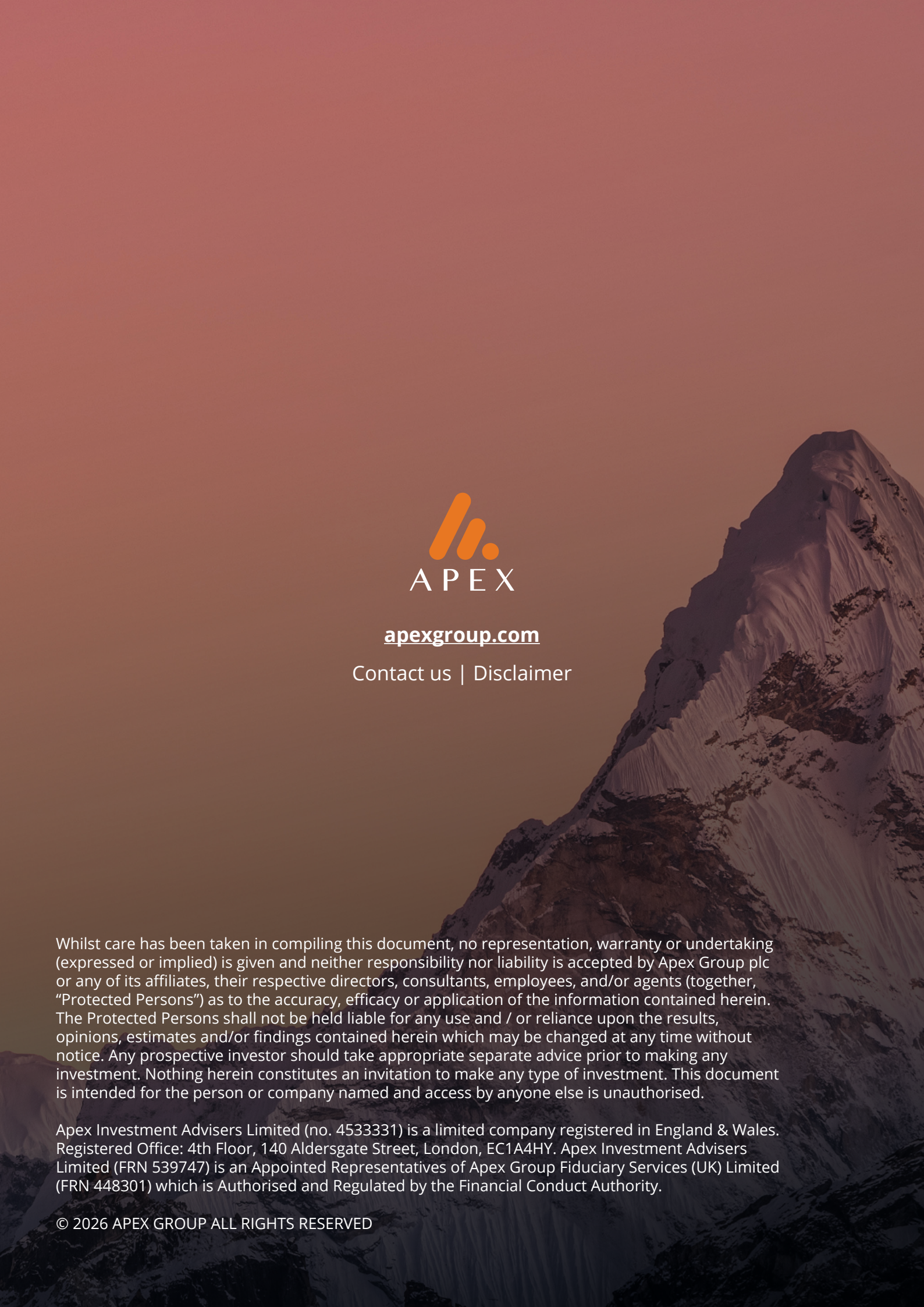
- Deep expertise across private credit strategies
- Strong focus on underwriting quality and portfolio construction in fund selection
- Independent, conflict-free advice

We advise a broad range of institutional clients, including pension funds, sovereign wealth funds, insurers, charities, family offices, and asset managers, on over $130bn of assets globally.

We offer flexible engagement models, working either as a long-term partner or on a project basis.

Our **Investment Advisory offering** includes:

- Investment objective setting
- Strategy reviews and portfolio construction
- Investment and operational due diligence
- Manager selection
- Transition management
- Portfolio monitoring and measurement



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